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Introduction

My name is John Leith-Tetrault and I am President of the National Trust Community Investment Corporation. I appreciate the opportunity to speak to the House Government Reform Subcommittee on Federalism and the Census today. My testimony will focus on the history and economic impact of the federal rehabilitation tax credits and the technical amendments needed to increase the effectiveness of federal incentives for historic and older building rehabilitation.

The National Trust Community Investment Corporation (NTCIC) is a for profit subsidiary of the National Trust for Historic Preservation that furthers the mission of the Trust by investing private capital in historic buildings that qualify for federal and state historic and New Markets tax credits. NTCIC has been a great financial success over its six-years of operations and annually upstreams significant profits to the Trust to support its broader mission of education, advocacy and community revitalization.

In its role as a tax credit syndicator, NTCIC has invested over $158 million in to help rehabilitate a wide variety of properties since the year 2000. Bank of America has been, by far, NTCIC's primary source of capital and an outstanding partner in this enterprise from the beginning.

NTCIC investments have included multi-family loft housing, office buildings, mixed-use properties, museums, theaters and community service facilities. Two-thirds of NTCIC's local development partners have been for profit developers. One-third has been nonprofit sponsors who benefit from NTCIC's willingness to provide training and technical assistance to developers who are not experienced in these complex real estate transactions.

NTCIC is also an industry leader in the twinning of the federal rehabilitation and New Markets tax credits. It has received $180 million in New Markets tax credit allocations since 2003, and has completed more historic rehabs in qualified low-income communities than any other tax credit syndicator. You can learn more about NTCIC at our website at www.ntcicfunds.com.

Background on Federal Rehabilitation Tax Credits (RTC)

Federal tax incentives for property rehabilitation have been on the books in one form or another since 1976 when Congress enacted a federal tax deduction for historic properties. In 1981 President's Reagan's economic stimulus legislation included a 25% historic tax credit, a 20% credit for nonhistoric buildings older than 40 years and a 15% credit for the rehabilitation of properties at least 30 years old. The 25% historic rehab credit was reduced to 20% as part of the 1986 tax reforms, and the nonhistoric rehab credits were collapsed into one 10% credit for buildings constructed before 1936. Other tax code changes in 1986 that limited the use of "passive losses" by individuals to offset "active" taxable income shifted the market for the federal rehabilitation credits from individuals to corporations. These statutes were further amended in the late 1980s to limit the use of the federal rehabilitation credits by nonprofit project sponsors. The Gulf Opportunity Act increased the federal rehab credits in 2006 to 26% and 13% respectively for a 36-month period for hurricane damaged areas of the Gulf Coast. While Congress has repeatedly recognized that older and historic building rehabilitation is an important component of an economic stimulus package, these incentives have never been reviewed for the need for technical amendments to increase their economic impact, transaction efficiency and compatibility with other federal economic development tax incentives.

The National Park Service reports that since the inception of the Federal historic tax credit, 32,800 rehabilitation projects have been approved generating over $36 billion in historic preservation activity and achieving a 5 to 1 ratio of private investment to federal tax credits. In 2005 the federal historic tax credit renovated 14,354 housing units of which 4,863 were affordable to low and moderate income households.

Comparatively little is known about the impact of the 10% RTC because it is not tracked or promoted by any federal agencies. While we know from US Treasury records that the utilization of the 10% credit is relatively low, it remains an important tool particularly in Main Street settings and on smaller transactions where local property owners often need the subsidy to make improvements, but do not own buildings in designated National Register Districts.

The National Trust Community Investment Corporation maintains a database of 20% federal rehab credit activity. In 2005, 1,101 projects with total development costs of just over $5 billion and Qualified Rehabilitation Expenditures (QREs) of about $3.7 billion were awarded credits by the National Park Service in the estimated aggregate amount of $748 million (20% of QREs). Ironically, despite the fact that the 20% credit has remained one of the few uncapped economic incentives in the federal tax code, its cost to the U.S. Treasury is only a fraction of similar capped social investment credits like the Low-Income Housing Tax Credit and the New Markets Tax Credit.

Utilization of the historic tax credit varies greatly by state. In 2005 the top six states included Missouri, Pennsylvania, Virginia, Massachusetts, North Carolina and Ohio. These top six markets accounted for forty-three percent (43%) of the total development costs of historic tax credit projects last year. Aggressive marketing and processing of applications at the state level, and the added incentive of state historic tax credits have been the most important factors in state rankings in property volume and economic impact. Today 25 states offer some kind of tax credit incentive for historic preservation. Of those, only about 9 of these offer significant subsidies for larger commercial property transactions. Data also show that use of the 20% RTC is highly concentrated in urban areas.

One of the most useful aspects of the 20% credit has been Congress' decision to promote the use of historic buildings to meet the economic development needs of low-income communities. Contrary to popular assumptions, National Trust Community Investment Corporation research shows that since 2002, 68% of all historic RTC approvals have been for projects in census tracts with median household incomes at or below 80% of area or statewide medians. The tax reform legislation of 1986 provided that the federal 20% credit could be combined with the new Low-Income Housing Tax Credit (LIHTC), and in 2002 the IRS ruled that the 20% and 10% RTCs may be combined with the 39% New Markets Tax Credit. Given the location of most commercial and residential historic properties in disinvested center cities and towns, and the high cost of urban property rehabilitation, these policies make good sense.

Economic Impact of the 20% RTC

Over the last three years, NTCIC has worked closely with Rutgers University to develop a methodology to measure the economic impact of the federal historic tax credit called the Preservation Economic Impact Model (PEIM). This model to date, measures the projected direct impacts of dollars spent on historic rehab based on factors of project cost, location and property type as well as federal labor and census data. In testing the accuracy of the model, NTCIC has compared the PEIM output to actual project figures and found a close correlation between actual and projected data. The Preservation Economic Impact Model estimates that in 2005 and the first quarter of 2006 the Federal historic tax credit program created 46,323 construction jobs and 59,265 permanent jobs. In that same time period the federal historic tax credit generated $363.7 million in local and state taxes.

The comparative impact of historic preservation with other economic activity has been studied, particularly in the work of economist Donovan Rypkema. Rypkema has documented that rehabilitating older buildings has a greater economic impact on local communities than new construction. If a community has a choice between spending $1 million on new construction and $1 million on rehabilitation, rehabilitation offers greater advantages: $120,000 more dollars will initially stay in the community; 5 to 9 more construction jobs will be created; 4.7 more permanent jobs will be created; and household incomes will increase by $107 more than household incomes in the vicinity of new construction. Retail sales will increase by an additional $142,000.

Keys to Greater Utilization and Impact

With the help of a grant from the Ford Foundation, NTCIC and the National Trust's Department of Public Policy conducted a national study of barriers to greater utilization of the federal RTCs, particularly with regard to increasing use of the credit by small business owners of commercial properties in urban, town and rural Main Street settings.

The conclusions of the study were that the keys to broader use of the 10% and 20% RTCs are to (1) simplify the process and lower the costs of selling ("syndicating") the credits so that smaller transactions and property owners could more easily understand and afford to use the credits, (2) increase the credit incentive for smaller projects, (3) provide incentives for targeting RTCs to lower income areas, (4) increase credit targeting to property uses needed in city and town centers, particularly housing, entertainment and cultural facilities.

Summary of H.R. 3159

With these goals in mind, H.R. 3159 was introduced on June 30, 2005 and referred to the Ways and Means Committee. An introduction in the Senate is planned for this fall. The bill deals comprehensively with the themes noted above in an effort to broaden the use of the credits by opening up a marketplace for smaller "Main Street scale" projects, providing deeper targeting to areas in need of economic development, and removing barriers to using the credits for today's drivers of downtown urban and small town development—housing, entertainment and cultural facilities.

Small Deal Incentives. H.R. 3159 ("Bill") promotes greater use of the federal 10% and 20% credits in small town centers and traditional urban neighborhood commercial strips providing for a 40% credit on the first $1 million of Qualified Rehab Expenditures in a project that qualifies for $2.5 million or less in QREs. The additional equity provided to the deal will help offset the fixed transaction costs that tend to be the same for both large and small properties, and allows a higher percentage of the credit benefit to defray the cost of bricks and mortar. The Bill also calls for the indexing of the eligibility date for 10% (nonhistoric property credit) so that any building 50 years and older would qualify. This will provide more uniform benefits to an entire small town center and add eligibility to newer districts, particularly in the west coast, mountain and plains states. By adding housing as an eligible use of the 10% credit, H.R. 3159 helps promote the trend of converting upper floors of small commercial buildings to housing.

Low-Income Area Targeting. As indicated above, historic tax credit projects are self-targeting to low-income areas. But, unlike the Low-Income Housing Tax Credit, there has been no reflection of the additional subsidy needed to make the numbers on RTC projects work in so-called Difficult to Develop Areas (as defined by HUD). The Bill would recognize this oversight and provide to RTC projects the same 130% basis boost currently afforded to LIHTC properties.

Promoting Downtown Housing. A Brookings Institution study documented some years ago what has become obvious to even the casual observer of large and small town center trends—there is significant new downtown housing demand today because the large and aging baby boom generation is down-sizing their housing and joining young urban professionals in the downtown rental and condo market. What was at first a tentative loft rental market has matured in many cities into demand for high end condominiums. This trend has in turn become a driver for job creation and entertainment and cultural facilities.

H.R. 3159 addresses and promotes this trend for both market rate and affordable housing. Current regulations require that when combining the use of the LIHTC and RTC credits on affordable housing projects, the basis of the LIHTC credit must be reduced by 100% of the value of the RTC. Given the high subsidy needs of affordable housing and the high demand for affordable workforce housing in large and small town settings, this requirement is counterproductive. The Bill would eliminate the basis adjustment. The 130% basis boost mentioned above would also spur more downtown affordable housing since most city and town centers are qualified low-income census tracts. H.R. 3159's addition of housing to the list of eligible uses for the 10% credit also furthers the Bill's goal of promoting downtown housing. 3159's condo provision allows for the early (prior to the expiration of the 5-year holding period) conversion of RTC rental units to condominiums so that RTCs can begin to promote a deeper homeownership base in center city business districts and adjacent neighborhoods.

Promoting Downtown Quality of Life. H.R. 3159's provisions promote another ubiquitous trend toward entertainment (restaurants, bars, sports and recreational facilities) and cultural venues that support the larger base of downtown residents. NTCIC's work with the League of Historic American Theaters has documented a high level of interest in rehabilitating historic theaters and the use of those theaters as the lynchpin of diversified downtown revitalization plans. NTCIC is currently syndicating RTCs to support the rehabilitation of theaters in towns as small as Washington, NC and Middlebury, VT medium sized urban areas such as Utica, NY as well larger performing arts centers on Baltimore's Westside and in Knoxville's Gay Street District. These and other cultural facilities are critical to sustaining the economic growth of towns of all sizes. However, the "disqualified lease rules" enacted by Congress on the 1980s make these transactions harder and more expensive to accomplish.

The tax-exempt use rules of Section 168(h) of the Code, as currently applied to RTC projects, penalize not only abusive transactions but also an unacceptably high number of non-abusive, community revitalization-oriented projects. The Bill fine tunes these rules as applied in the RTC context in order to reduce the number of beneficial projects that are adversely impacted, without weakening the anti-abuse function the rules were designed to perform. Under H.R. 3159, the nonprofit leasing threshold that triggers disqualified lease rules would be raised to 50% from 30%. Previous regulations prohibiting the use of tax-exempt bond financing on such projects, leases in excess of 20 years and leases with fixed sale prices would be eliminated. Certain sale/leaseback transactions, which were the genesis of these rules, would be retained.

NTCIC firmly believes that these changes to the current RTC statutes and regulations will have a significant impact on the use and the economic impact of the 10% and 20% rehab tax credits. We appreciate the leadership and support of Congressman Turner on this important legislation as well as the opportunity to testify today. We are ready to do whatever may be requested by this Subcommittee to further the prospects for the enactment of H.R. 3159.